In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-51

ABNER MICHAUD, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The memorandum and order of the referee in bankruptcy (Pet. App. 31a-61a) are unofficially reported at 24 A.F.T.R. 2d 5978. The opinion and order of the district court (Pet. App. 15a-30a) affirming the order of the referee are reported at 317 F. Supp. 1002. The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 458 F. 2d 953.

JURISDICTION

The judgment of the court of appeals was entered on April 10, 1972. The petition for a writ of certiorari was filed on July 8, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether under Sections 17a(1) and 64a(4) of the Bankruptcy Act the government's claim for income tax deficiencies, for taxes that became due more than three years prior to bankruptcy but for which the deficiencies were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of judicial remedies available to and pursued by the bankrupts, was entitled to priority.

STATUTES INVOLVED

The pertinent statutes are set forth at Pet. App. 62a-64a.

STATEMENT

This case involves unpaid deficiencies in federal income taxes for the years 1955, 1956, 1957, 1958, and 1960, which were determined by the referee in bankruptcy to be in an amount in excess of $94,652.73, plus interest to the date of bankruptcy (Pet. App. 2a, 29a, 61a).

On May 6, 1963, and March 24, 1964, statutory notices of deficiency were mailed to petitioners Abner and Alyce Michaud, with respect to proposed defi-

ciencies in federal income taxes for the years 1955 through 1960 (years in which they filed joint federal income tax returns); within 90 days of receiving each of these notices, the Michauds filed petitions for redetermination of the deficiencies in the Tax Court (Pet. App. 34a, 59a-60a). The Tax Court cases were pending at the time the Michauds filed petitions under the Bankruptcy Act, and it was stipulated that the issues in the Tax Court proceedings should be determined by the bankruptcy court (Pet. App. 60a-61a).[1]

The income tax deficiencies in question related to income derived by Abner Michaud from his 95 percent partnership interest in a meat processing and distribution business. In dispute was the disallowance by the Internal Revenue Service of deductions claimed on the partnership tax return with respect to certain payments of 3 percent commissions to managers, chefs, and other purchasing agents of customers of the partnership. The referee held that these payments constituted nondeductible "kickbacks," and he allowed the government's claim in the sum of $94,652.73, plus interest to the date of filing of the

[1] The bankruptcy proceedings began as a petition by Abner Michaud for an arrangement under Chapter XI of the Bankruptcy Act; on October 4, 1966, he was adjudicated a bankrupt on his consent thereto and withdrawal of the arrangement proceeding (Pet. App. 32a). Alyce Michaud filed a petition in voluntary bankruptcy and was adjudicated a bankrupt on May 4, 1966 (Pet. App. 32a). An order was subsequently entered consolidating the separate proceedings (Pet. App. 52a).

arrangement petition and "the amount due for the year 1960 on taxable income not in excess of $44,000 and said interest" (Pet. App. 52a). The referee, however, sustained the objections of petitioners (including the trustee) to the allowance of this claim as a priority tax claim under Section 64a(4) of the Bankruptcy Act (*ibid.*) The district court affirmed both the disallowance of the claimed deductions and denial of priority to the government's claim (Pet. App. 29a-30a). On the government's appeal, the court of appeals reversed, holding that the tax claims were entitled to priority (Pet. App. 2a, 14a).

ARGUMENT

The decision below is correct. There is no conflict among the courts of appeals nor any other consideration warranting further review of this case.

Section 17a(1) of the Bankruptcy Act, 11 U.S.C. 35(a)(1), provides generally for discharge in bankruptcy of provable debts for taxes that became legally due and owing more than three years preceding bankruptcy.[2] However, this provision expressly excepts "taxes * * * which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt * * *."

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[2] It is conceded that the taxes here were due and owing more than three years preceding bankruptcy.

Since, as petitioners concede (Pet. 4), the taxes here were not assessed prior to bankruptcy, by reason of a prohibition on assessment pending disposition of the petitions filed in the Tax Court, the sole issue here is the narrow question whether the deficiencies determined by the referee related to "taxes * * * not reported on a return" and therefore were not discharged under Section 17a(1) of the Act.[3]

Petitioners contend (Pet. 5-13) that since the Michauds' tax returns set forth the amount and nature of their gross income and deductions, the returns included all information relevant to a determination of their tax liabilities and therefore the deficiencies here related to "taxes * * * reported on a return." In effect, petitioners argue that the word "taxes" in the statute should be read as if it meant "transactions" and that tax claims therefore are discharged unless they relate to "[transactions] * * * which were not reported on a return * * *."[4] Such a construction would violate both the plain language and the purpose of the statute.

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[3] Section 64a(4) of the Act, 11 U.S.C. 104(a)(4), provides that only taxes which are not discharged are entitled to priority.

[4] In support of this contention petitioners argue (Pet. 8) that the statute of limitations begins running upon the due date of a timely filed return fully disclosing gross income and deductions. However, the statute of limitations, Section 6501 of the Internal Revenue Code of 1954, 26 U.S.C. 6501, refers to the reporting of "gross income" and therefore, as the court of appeals correctly determined (Pet. App. 7a-8a), should not be interpreted in *pari materia* with the statute here, which refers to the reporting of "taxes."

The court below correctly reasoned that since the tax liabilities shown on the Michauds' returns were less than the tax liabilities finally determined, the deficiencies plainly related to "taxes * * * not reported on a return." See *In re Indian Lake Estates, Inc.*, 428 F. 2d 319 (C.A. 5), certiorari denied *sub nom. Stewart* v. *United States*, 400 U.S. 964. See generally 1A Collier, *Bankruptcy* § 17.14[4] (14th ed.).

This result is in accord with the statutory purpose. Prior to 1966, federal, state, and local taxes were not dischargeable in bankruptcy and all such taxes were entitled to priority of payment. In 1966 the Bankruptcy Act was amended to provide for discharge of tax claims in the limited circumstances described above (with additional exceptions not here relevant).[5] Pub L. 89-496, 80 Stat. 270. The objective of the amendment was to achieve a more effective rehabilitation of bankrupts and a more equitable distribution of bankrupts' assets among their creditors while at the same time recognizing the continued necessity of protecting the revenues. H. Rep. No. 687, 89th Cong., 1st Sess., pp. 3-4 (1965); S. Rep. No. 1158, 89th Cong., 2d Sess., pp. 3-4 (1966). The language used in the amendment gives effect to this general objective by reflecting a specific congressional determination that although stale tax claims should be discharged in bankruptcy, tax claims do not begin to

[5] Petitioners refer (Pet. 6-9) to legislative history illustrative of the broad intent of Congress to provide for the discharge of some tax claims. As the court below noted (Pet. App. 11a-13a), such history is of little help in deciding the reach of express exceptions to dischargeability.

grow stale until they are in a form that permits collection action by the Internal Revenue Service.[6] Since by virtue of the Michauds' contest of the proposed deficiencies in the Tax Court the taxes here had not become subject to collection prior to bankruptcy, the government's claim remained fresh; discharge of these claims would therefore unduly favor private creditors over the government and thus upset the balance intended by the 1966 amendment. Congress clearly did not intend that tax claims would become subject to discharge in bankruptcy before they become subject to collection.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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[6] Thus, as petitioners point out (Pet. 12), the result reached by the court of appeals will favor taxpayers against whom assessments are made more than one year prior to bankruptcy as against those who stave off assessment by contesting their liabilities. These consequences are not anomalous, but merely flow from the principle that, although stale claims are discharged, a claim may not be discharged before it becomes subject to collection.

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